

## Contractor Prevails Against Owner in Arbitration Successfully Arguing Modification of the Contract Based Upon the Parties' Course of Conduct

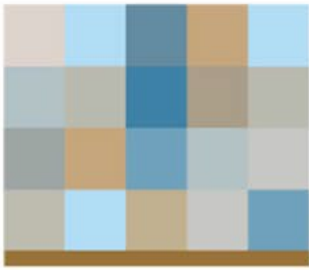
*By: Robert J. Fryman and Danielle J. Marlow*

Often, the performance by parties to a contract varies from the written terms and conditions of the contract in slight, immaterial ways. Occasionally, the parties' performance, either individually or collectively, may vary significantly from the contract's express terms, giving rise to disputes and claims of breach of contract. Typically, contracts provide that their terms may not be modified or altered except by written agreement signed by all parties to the contract and the parties are precluded from offering evidence of other modification or amendment of the written contract. ***However, there are important exceptions to this rule.***

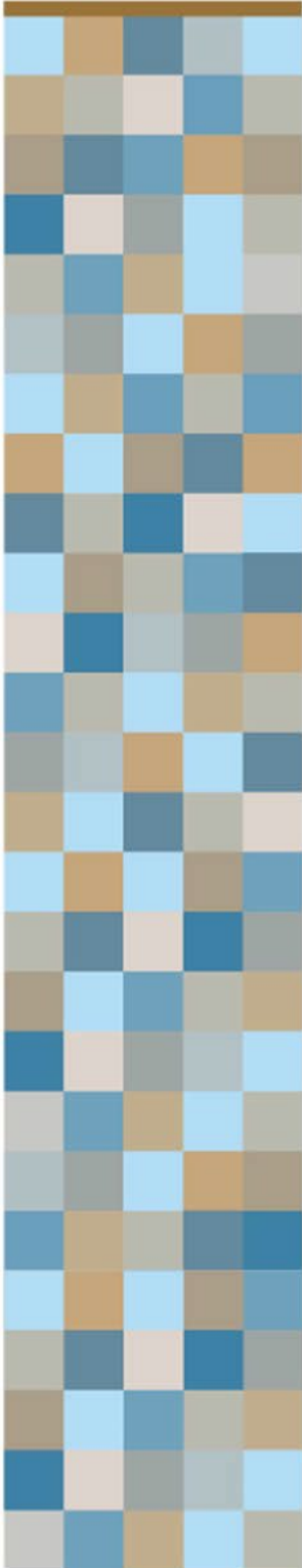
In a recent matter before the American Arbitration Association (the "Arbitration"), handled by MHH's Danielle J. Marlow and Robert J. Fryman, we successfully argued on behalf of a construction manager/contractor that the contract was modified based upon the parties' communications and, more pointedly, by the parties' conduct during their performance of the contract. As a result, the purported termination of the contract was set aside, and the construction manager/contractor was awarded the full amount it sought as compensation for its performance under the contract plus two years of prejudgment interest, together with the costs and expenses of the Arbitration and its attorneys' fees – a complete victory for our client.

In this challenging matter, MHH was retained to represent a construction manager/contractor ("Contractor") who had previously entered into an AIA form of construction contract with the lessee of a property ("Owner" or "Respondent") on which it sought to build a new fast food restaurant (the "Project"). Because the landlord of the real property on which the restaurant was to be built required that it be provided with performance and labor and material payment bonds for the Project, the parties entered into a written agreement providing for a fixed contract sum. However, communications between the parties made it clear that the contract sum was "for bonding purposes only" as Owner wanted to limit the cost of the Project (and the bonds in particular) and Contractor had a limited bonding capacity. Moreover, the course of conduct by the parties demonstrated that notwithstanding the stated contract amount, the parties clearly understood that Contractor was to be paid on a time and materials basis plus a construction management fee.

In the Arbitration, Contractor sought payment for the work pursuant to the time and material plus construction management fee basis under which the parties had performed. Owner



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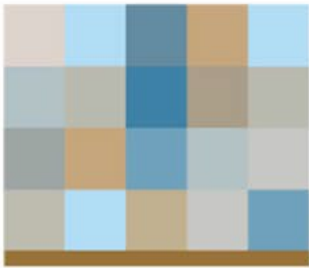


counterclaimed for the alleged completion costs for the Project following the purported termination of Contractor, and the cost of a new roof for the building.

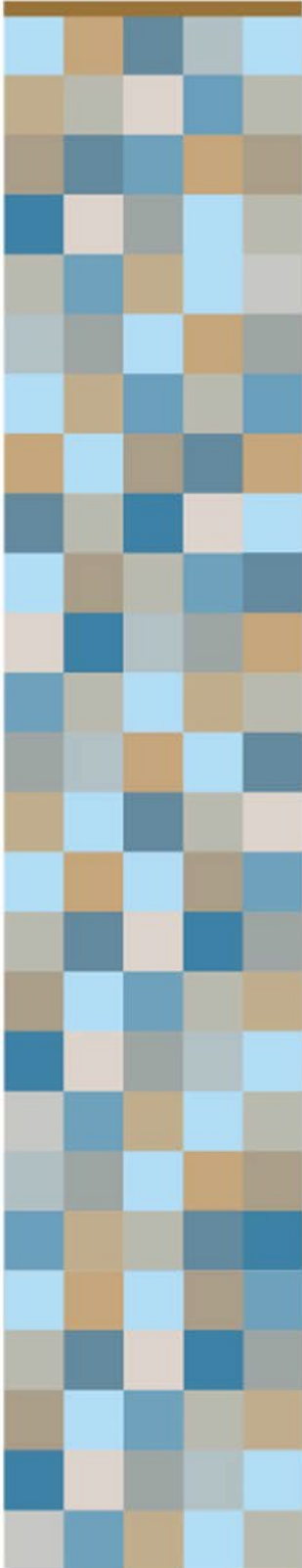
The testimony and documentary evidence presented at the Arbitration demonstrated that prior to entering into the contract, Contractor communicated that the stated contract amount was for purposes of the bond only. Specifically, an email sent from Contractor to Owner stated: "[o]n the AIA contract we will be putting a price...for bond purposes only as it cannot exceed the amount on the bond." The evidence presented at the Arbitration demonstrated that Respondent understood that the stated contract sum was for "bond purposes only." No evidence was presented that, at any time prior to the Arbitration, either side ever contended that the contract price was limited to the stated contract sum or that the contract sum was a reasonable or sufficient price for the construction of the Project. According to the Contractor's testimony, the Contractor was to be paid on a time and materials basis plus a 10% construction management fee: "the agreement that I had with [Owner] is that I wasn't marking up any of the proposals, that I was going to get a flat fee at the end of the job as a construction manager/owner's rep."

Work on the Project began in the fall of 2020 and proceeded through late spring 2022. From November 2020 through December 2021, Respondent paid Contractor for its time, materials and expenses on the Project based upon Claimant's presentation of payment requisitions, specifically spreadsheets detailing its costs supported by backup documentation. At no point, even when the amounts paid totaled nearly the entire stated contract sum, notwithstanding the fact that the Project was not near completion, did Respondent claim the amounts to be paid to Contractor were limited to the contract sum; rather Owner assured Contractor that "all of the financial issues will be resolved." In July 2022, after failing to pay Contractor its outstanding requisitions in the same fashion as Owner had previously paid, Owner, through its Architect, purported to terminate the contract for default. The Contractor contested the purported termination, and the Arbitration ensued.

Following testimony and cross-examination, the presentation of numerous evidentiary exhibits, and the submission of post-hearing briefs by both sides, the Arbitrator found that the contract had been effectively modified based upon the parties' communications and their course of conduct in the performance of the contract. Specifically, the Arbitrator found that instead of payment of the contract sum in five equal installment payments as set forth in the contract, Contractor submitted to Owner spreadsheets detailing the work performed during a requisition period with supporting backup of trade and subcontractor work, materials, equipment and supplies. Owner made nine separate payments to Contractor based upon Contractor's requisitions in this manner. The payments were expressly tied to Contractor's expenditures on the Project, as indicated by notations on the payment checks such as "demo", "plumbing", "electric", and references to the underlying invoice numbers. This was consistent with Contractor's testimony that he was to be paid on a time and materials basis.



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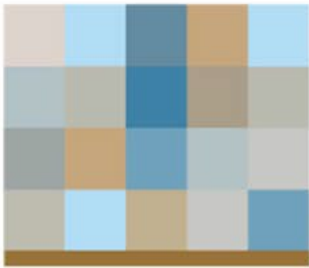
While New York's General Obligations Law Section 15-301 generally bars oral modification of a written agreement which contains a merger clause prohibiting oral modification, there are exceptions to this rule including based upon proof of an agreed upon executed oral modification, proof of the course of conduct evidencing such modification and/or estoppel. The Arbitrator agreed with MHH's argument that the parties' course of conduct was inconsistent with the stated contract sum and the payment schedule, and that the course of conduct of the parties evidenced a modification of the contract to pay the contractor for the construction of the new restaurant on a time and material basis plus a 10% construction management fee. The Arbitrator found that the Owner breached the contract as modified by not making payment pursuant to the modified terms. Specifically, the Arbitrator held, "[t]here was an oral modification, partial performance and/or estoppel that modified the Contract. The Contract was modified to provide that Contractor would be paid for time, materials, payments to subcontractors, and other expenditures in connection with the Project, plus a 10% construction management fee. 'Moreover, when a party's conduct induces another's significant and substantial reliance on the agreement to modify, albeit oral, that party may be estopped from disputing the modification notwithstanding the statute.'" (citations omitted).

The Arbitrator rejected Owner's argument that Contractor's claims should be denied because the Contractor did not follow the change order/additional work provisions of the contract, as the work for which payment was sought was not change order or additional work. The Arbitrator also rejected Owner's counterclaims for the cost of a new roof (noting that a 20-year new roof warranty had been provided by Contractor and there was no evidence that a warranty claim was ever made). Lastly, the Arbitrator denied Owner's counterclaim for the alleged costs to complete the project, noting that under the AIA contract, Owner was not entitled to recovery of the alleged excess costs to complete, as the contract's termination provisions were not followed and the termination was improper. Further, no documentary support whatsoever was provided in support of any of the alleged completion costs.

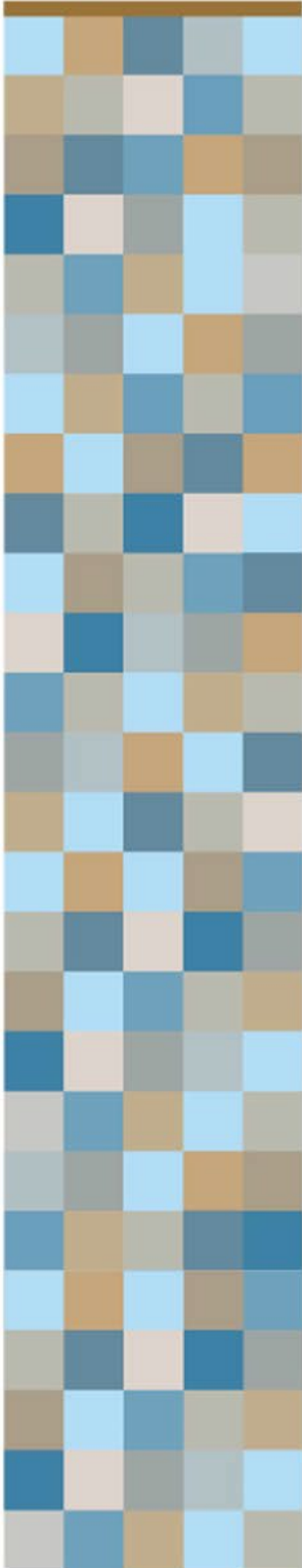
In sum, the Arbitration was a complete victory and resounding success for the Contractor, recovering all of its damages, plus pre-judgment interest, the costs of the Arbitration and its legal fees and expenses.

MHH Commentary:

All contract disputes, whether subject to litigation or arbitration, are fact and context sensitive, some more so than others. What may at first appear to some clients (and counsel) to be a claim that is barred by contract, review by experienced construction counsel can often yield both new perspectives and potentially more promising results. With construction contracts in particular, significant substantive and procedural legal doctrines have developed, such as the modification by course of conduct successfully argued here, that are highly specialized and fact dependent. Consultation with experienced construction counsel is both warranted and highly recommended to evaluate your rights, remedies, claims or defenses with regard to a potential



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construction claim or dispute. Please contact Rob or Dani if you have any questions or would like any further information.

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